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RUEHGE/AMEMBASSY GEORGETOWN 0760
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C O N F I D E N T I A L SECTION 01 OF 04 LA PAZ 001588

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TAGS: ECON PGOV PREL ENRG EPET EINV BL
SUBJECT: BOLIVIAN GAS: STATE CONTROL DIGS DEEPER

REF: A. LA PAZ 313
¶B. LA PAZ 614

Classified By: A/EcoPol Chief Brian Quigley for reasons 1.4 (b, d).

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Summary
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¶1. (C) In June, Vice President Garcia Linera outlined the Bolivian government's plan to increase state involvement in the economy through nationalizations, the creation of productive enterprises, and the enlargement of state sectorial companies. The consequences of this state-oriented approach are increasingly evident within the hydrocarbon sector. Despite increasing costs, supply disruptions, and stagnant production, the Morales administration continues to pile more responsibilities on the overstretched and underfunded state hydrocarbon company (YPFB). Arbitration claims from the sector amount to over $550 million, supply bottlenecks are increasing, and new exploration is negligible. The government recently announced that it will now take over the conversion process of cars to vehicular natural gas (GNV) and the duties of four regional private domestic gas supply companies. End Summary.

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The State Must Be In Control
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¶2. (SBU) The Morales administration continues its march toward greater state control over the economy. In early June, Vice President Linera outlined the administration's new model in which the state and small and medium sized businesses would play the principal role in the economy. Gone will be the days of "neoliberal" control by large, generally foreign, firms. The Vice President's vision included twenty state-run firms operating within hydrocarbons (5), mining (3), electricity, cement production, agriculture, paper, and foodstuffs (Ref a). Within the hydrocarbons'

sector, state control would be all inclusive. YPFB is not envisioned as only a regulator, but rather will attempt to actively manage and participate in all aspects of the sector, from exploration, to exploitation, to transportation.

¶3. (SBU) The costs of exerting YPFB control over the sector are mounting. To date, the full nationalizations of Transredes and the Bolivian Hydrocarbons Logistics Company (CLHB) have brought arbitration claims of $500 million and $35 million respectively (Note: Entel, the nationalized Italian phone company, has also filed for arbitration of $350 million. End note). Moreover, additional nationalizations are likely (electricity appears particularly under the gun), as the Morales administration moves both to implement it's statist vision and mobilize its support base leading into the August 10 recall referendum.

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Paralyzed Production and Investment
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¶4. (SBU) According to industry sources, all major gas exploration activities are on hold and investments that are taking place are only to maintain production levels. The numbers tell the story; estimated investments in 2007 were $42 million in exploration and $106 million in production. These figures have fallen every year since peaking at a total investment of around $600 million in 1998, when around $375 million was spent in exploration. Additionally, according the Bolivian Chamber of Hydrocarbons (CHB) only three new wells



were drilled in Bolivia in 2007. In Brazil the figure was 260 and in Peru it was 166. In large part, these figures reflect the legal uncertainty surrounding the sector in general, and exploration in particular. Under Bolivian law, contracts for exploration and exploitation are separate. As a result, a company can sign an agreement to explore for new gas, but if a promising field is discovered, the company must again negotiate with the government on the terms of exploitation.

¶5. (C) Rather than work to create a better environment for investments, Morales is continuing his pattern of threats. At the end of June, he announced that, "I don't want to say the names, but we are preparing a Plan B that will permit the end of the blackmail and boycott (of investments) by some companies." This Plan B appears to mandate that YPFB carry out its own exploration and drilling operations in cooperation with the Venezuelans. In 2007, PDVSA (40 percent) and YPFB (60 percent) created the mixed company of Petroandina. Chavez recently announced that Venezuela would invest over $800 million, with $600 going to Petroandina. While YPFB has reportedly purchased one used Chinese drill, refurbished in Venezuela, it is in no condition to carry out actual exploratory drilling, even if Venezuelan investments actually materialize. (Note: The drill raises the number of drills in the country from three to four. End note). According to Raul Kieffer, General Manager of CHB, YPFB simply has no people to operate an actual drilling rig. In private meetings with YPFB, Kieffer said that employees admitted that the plan was to bring old workers out of retirement and to rely on Venezuelan help. Ricardo Rios, ex-minister of hydrocarbons, has the theory that the Morales administration doesn't really want to increase gas production because the excess revenue would go principally to the autonomous, opposition departments. It appears more likely however, that the government truly believes that it can dominate and manage all aspects of the sector; economic costs, efficiency, and stagnant production need not interfere with the vision.

¶6. (C) Despite the overall gloom in the industry and its own stalled "nationalization," one company, Chaco (owned by Pan American Energy, British Gas, and YPFB), apparently will boost production this year. While its nationalization is

still up in the air (the government decreed the purchase of 50 plus one percent of the shares; however, negotiations for operational control continue, and are reportedly not advancing), Chaco could bring on line between 2 to 4 million cubic meters of gas per day (Mm3/d) by the end of 2009 according to Carlos Delius, Director of the hydrocarbon service company Kaiser. Company spokesmen have said production from the Percheles field could yield over a 1 Mm3/d increase by the end of the year. While Delius acknowledges that the news is positive, he says that advances in these smaller, established fields will only just cover the natural declines in production and no big advances can be made without substantial new investments in the major fields. The British Gas General Manager Jose Magela, who doubles as the president of the CHB, agrees, telling Econoff that overall production might make 42 to 43 Mm3/d in 2009, but no substantial upturn in production will be possible before 2011 (currently Bolivia produces around 40 Mm3/d).

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YPFB Continues to Grow
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¶7. (C) YPFB may be in disarray (Ref. b), but its responsibilities continue to grow. With the nationalization of Transredes and CLHB, YPFB now controls hydrocarbon transportation and storage within Bolivia. However, the



company is out of cash (as is CLHB) and supply disruptions are likely to become more severe in the months ahead. Ricardo Rios told us that the bottlenecks will become apparent in the first months of 2009. The President of YPFB, Santos Ramirez seemed to foreshadow emerging problems when he announced to the now state workers at CLHB that Bolivia only had 4-5 days of fuel storage capacity. While the goal is to increase this capacity to beyond 20 days, his first act was to pass out 275 "care packages" to the workers, which included computers, televisions, and bed sheets. He said that the money to pay for the items came from firing foreign managers and eliminating their extravagant hotel bills. Guillermo Sotomayor, a former administrator at CLHB confirmed to Econoff that all of the top-level managers were gone now, replaced by people with little to no experience in the sector.

¶8. (C) At Transredes, top management has so far been left in place. According to Oscar Serrate, now at Ashmore Energy International in Houston, the managers in Bolivia have made an agreement that if one is removed for political reasons, all will resign. So far, the government has realized the necessity of a smoothly functioning Transredes, and has left everyone in place. However, necessary projects to expand the internal pipeline network are on hold. The vital pipeline project Carrasco/Cochabamba is now paralyzed as the $100 million in funding from the Andean Development Bank (CAF) needs to be reconsidered in light of the change in company ownership. Carlos Delius explained that without this line Bolivia is having to re-inject 1.5 to 2.5 million cubic meters of gas per day (MMm3/d) (after extraction liquids), because there is no capacity for transport. Additional, this new line is important for adequate gas supplies for electrical generation and industries in the altiplano.

¶9. (C) YPFB has trumpeted a figure of $1.2 billion budgeted for "investment" this year in the sector. The bulk of this amount will go to operational costs and other expenses not normally considered investment. For example, $87 million is budgeted for home gas connections and $71 million will go to rehabilitate (and place in state hands) 43 service stations. Additionally, the company plans to buy 70 liquid gas transport trucks and 164 vehicles to transport canisters of liquid petroleum gas (GLP). The CHB estimates that of the $1.2 billion announced, around $330 million is budgeted for exploration and the development of hydrocarbon production. It is difficult to imagine, however, how even this amount of

money could be productively applied to the sector this year.

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The State Takes Over Successful Private Operations
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¶10. (C) On July 9, the Minister of Hydrocarbons, Carlos Villegas announced that YPFB would now be in charge of all vehicle conversions to vehicular natural gas (GNV) and would perform the conversion for free. While the details have yet to be announced, the decree threatens the over 100 service stations that now perform the task for around $800. While it has had the affect of boosting internal demand for gas (GNV now amounts to around 15% of internal gas consumption), the growth of cars using GNV is seen as a major success (especially taxis in Cochabamba and Santa Cruz). The number of GNV powered cars has risen from 27,000 in 2004 to an estimated 92,000 in March of this year. Raul Kieffer of the CBH has told us that government intervention will ruin the program, even if it is successful, already short gas supplies could be stretched even further. While the government plans to pay for the conversions through a tax on GNV, YPFB would be hard pressed to manage the massive switch to GNV usage



that free conversion would stimulate.

¶11. (U) The latest move to consolidate state control over all basic household gas services involves the decision to not renew that contracts of four major distributors of gas. All four are located in opposition states and all four work in association with their local and state governments. The companies are Emcogas in Cochabamba, Emdigas in Sucre, Emtagas in Tarija, and Sergas in Santa Cruz. In the highland states of La Paz, Oruro, and Potosi, distribution is already handled by YPFB.

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Comment
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¶12. (C) The mood in the hydrocarbon sector is increasingly bleak. State interference and ineptitude is not only taking its toll on production, but on the moral of the private companies involved. One executive heatedly complained that YPFB contacts couldn't even understand charts, let alone the content behind them. While YPFB's mandate continues to grow, its lack of capacity and experience is likely to become even more evident to the country as a whole. In the meantime, the Morales administration appears to continue to harvest good will among the majority of Bolivians as it exercises greater state control over natural resources. While the road to the August 10 recall referendum may well include more nationalizations, the true costs will be paid farther down the road.
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